10-Year Financial Plan

Department of Corporate Services

Department of Engineering and Corporate Assets

Presentation to City of Kawartha Lakes Council
July 11th, 2017

Asset Management Plan

- Municipal Asset Management Plans (AMPs):
  - Required to remain eligible for formula- and application-based capital grants.
  - Must be prepared to a “comprehensive” standard.
  - About to become mandatory and regulated through the *Infrastructure for Jobs and Prosperity Act*.

- City’s 2017 AMP was prepared by Public Sector Digest, focusing on lifecycle capital needs and incorporating:
  - 2016 Roads Needs Study and 5-year roads capital plan.
  - New Fleet Policy and expected 2018 rental rate adjustments.
  - Growth-related and other expected non-lifecycle capital needs.

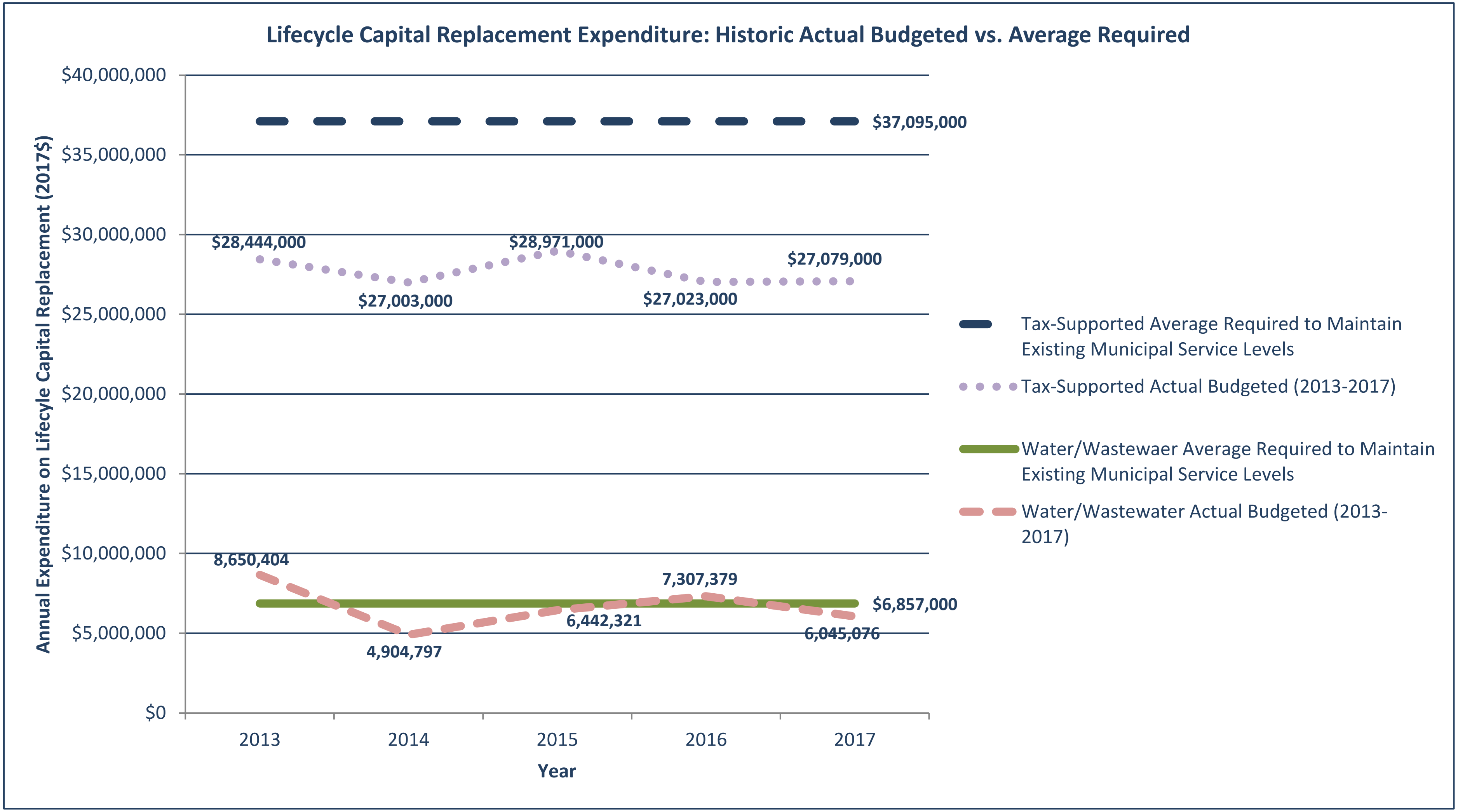
Asset Portfolio Replacement Cost

- City of Kawartha Lakes asset portfolio:

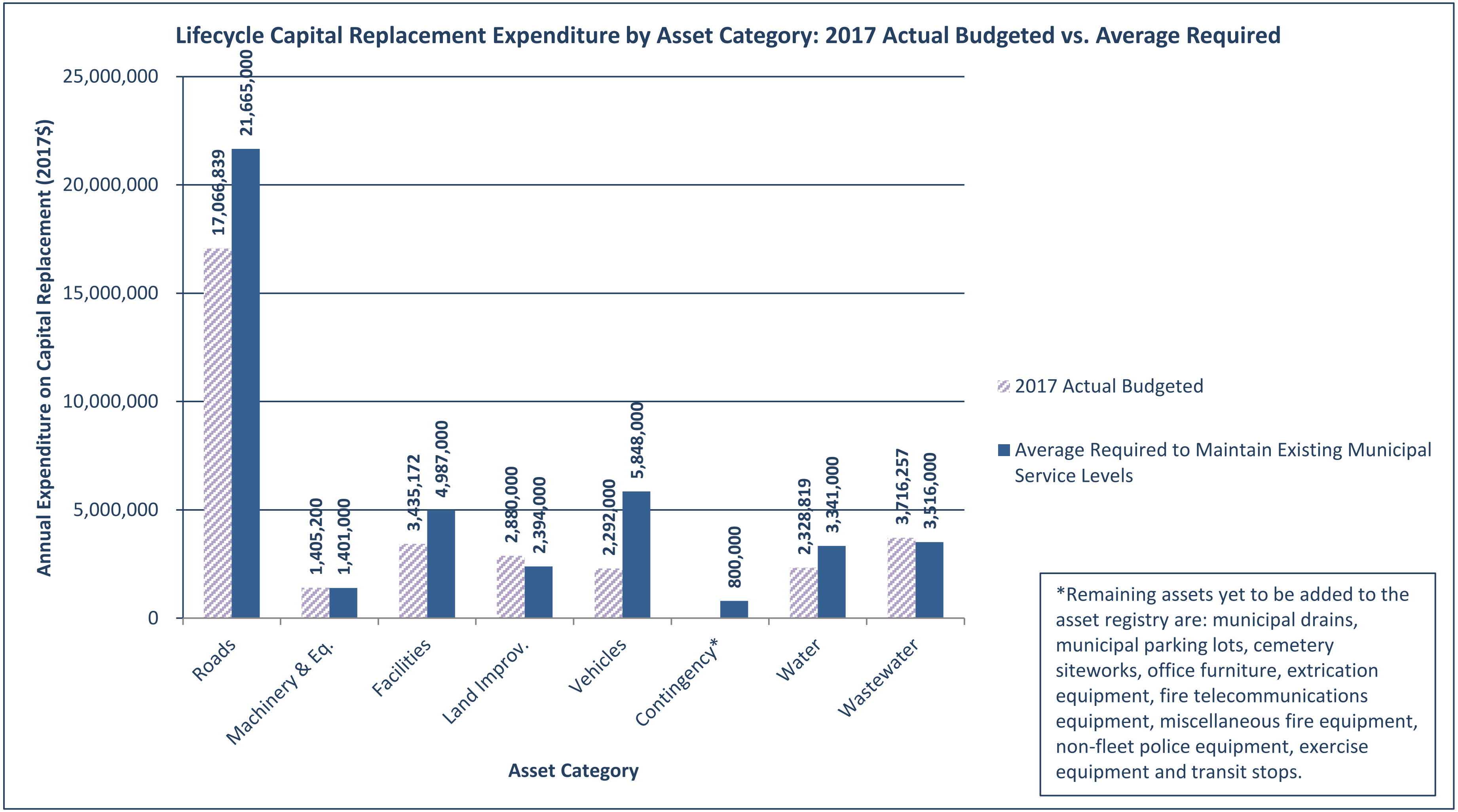
Replacement Cost of Asset Portfolio by Asset Class (2017$)*				
Asset Class	**Tax-Supported**	**Water**	**Wastewater**	**Total**
Natural Resources	399,768,525	5,185,320	7,777,980	412,731,825
Infrastructure	1,887,889,825	236,989,729	269,986,409	2,394,865,963
Facilities	282,170,583	14,124,000	9,213,000	305,507,583
Equipment	102,671,535			102,671,535
Total	**2,672,500,468**	**256,299,049**	**286,977,389**	**3,215,776,906**

*Includes depreciable and non-depreciable assets, and excludes social housing assets. Water and wastewater portions of natural resources are based on approximate land value shares.

Lifecycle Capital Replacement: 2013-2017



Lifecycle Capital Replacement: 2017



Identifying the Problem

- Tax-supported portfolio faces a $30.3M problem (in 2017$):
  - $10.0M infrastructure deficit.
  - $11.3M tax support gap (given 2018-19 operating pressures).
  - $9.0M capital reserve deficiency.

- Decomposition of the tax-supported infrastructure deficit:
  - Roads: $4.5M
  - Facilities: $1.5M
  - Vehicles: $3.5M
  - Other: $0.5M

- Tax-supported infrastructure backlog since just 2013:
  - Estimated to be $45M in 2017.
  - Estimated to grow to $173M in 2027 if status quo continues.

Recent Indications of the Problem

- Recent examples of capital failures and emergencies:
  - Emergency rehabilitation of City Hall roof, jail wall etc.
  - Emergency rehabilitation of Coboconk Medical Centre roof.
  - Ministry of Labour order and emergency rehabilitation of sand domes.
  - Hazardous conditions and emergency demolition of Hartley Depot.
  - Near failure and urgent interim micro-resurfacing of airport runway.
  - Gravel road surface failures, especially during spring thaw.

- Recent examples of service level deficiencies:
  - Unacceptable deterioration of gravel and paved roads.
  - Unacceptable road reconstruction and resurfacing frequency.
  - Numerous sidewalk “trip-and-fall” hazards and accessibility issues.
  - Safety hazards from asset failures at airport, City Hall, Medical Centre etc.
  - Obsolete, inefficient and inaccessible arenas, community centres, parks etc.
  - Inefficient and/or ineffective operations due to obsolete technology.

Getting Real About Solving the Problem

- If the problem is left unaddressed:
  - Infrastructure backlog will continue to grow uncontrollably.
  - Expensive capital failures and emergencies will continue to arise.
  - Asset lifecycle costs will continue to increase more than necessary.
  - <u>Realized service levels</u> will continue to deteriorate and fall below <u>established service levels</u> and thus <u>taxpayer expectations</u>.

- The following are <u>not solutions</u> to the problem:
  - Continued or indefinite deferral of capital expenditures needed to restore and/or preserve established service levels (i.e. cannot "kick the can down the road").
  - Continued depletion of already highly inadequate reserve balances.
  - Indefinite future increases in debt.

- Ultimately, there are <u>only two ways</u> to solve the problem:
  - Reduce established/expected service levels.
  - Maximize non-tax revenue and bring the tax levy and capital reserves to sustainable levels, possibly through a phase-in enabled by a transitional debenture.

Developments Since May 30th, 2017

- The staff presentation at the May 30th Council meeting explored various preliminary potential strategies for a long-term financial plan:
  - Forecasted transitional debenture ranged from $15M to $25M.
  - Forecasted average front-end tax increases ranged from 5.0% to 5.8%.
  - Staff did not recommend any particular strategy at that time.

- Upon further review, staff conducted a deeper examination of tax affordability and predictability:
  - $5.3M in operating pressures is too much for the tax levy to absorb instantaneously in addition to regular inflationary increases.
  - Forecasted tax increases over the planning horizon were highly variable over the planning horizon.

- Accordingly, facilitated by a $25M transitional debenture, the 10-Year Financial Plan:
  - Smooths out the sharp impact of the operating pressures.
  - Stabilizes front-end tax increases at 4.5% and provides for a controlled decline in tax increases over the planning horizon.

What is a Long-Term Financial Plan?

- A document that provides a guiding framework in which to implement the AMP, prepare annual budgets and achieve and maintain long-term financial sustainability.

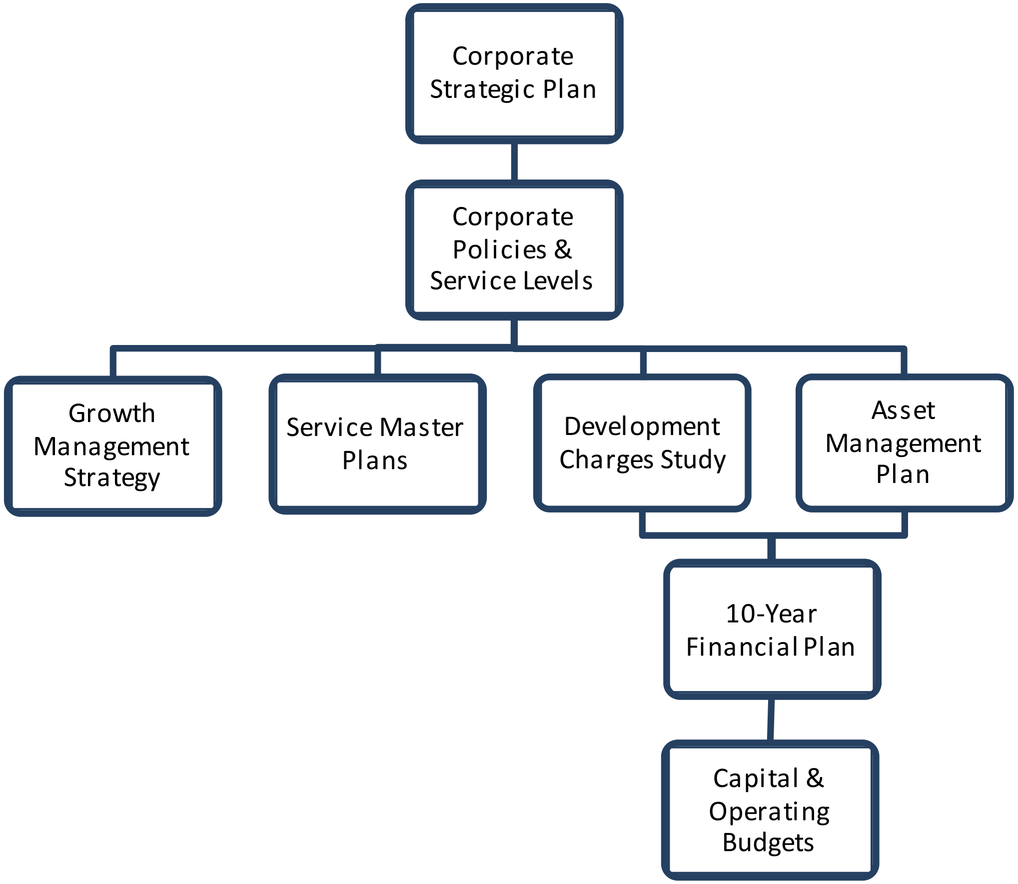
- By definition, it is a “living document” as it must be adaptable to ever-changing needs, circumstances and information.

- It provides a link between the AMP and annual budgets, and addresses upcoming operating pressures.

- The 10-Year Financial Plan, based on the 2017 AMP, is the City’s first long-term financial plan.

Linking the AMP to Annual Budgets

- The relative position of the 10-Year Financial Plan.



10-Year Financial Plan Fundamentals

- Alignment with the Corporate Strategic Plan through enablers:
  - Asset Management and Effective and Efficient Infrastructure; and
  - Responsible Fiscal Resource Management.

- Assets exist to provide, facilitate and support municipal services.

- Municipal service levels as established by Council and/or legislation are taken as given.

- Capital needs as per the 2017 AMP, operating cost pressures and known external funding sources are taken as given.

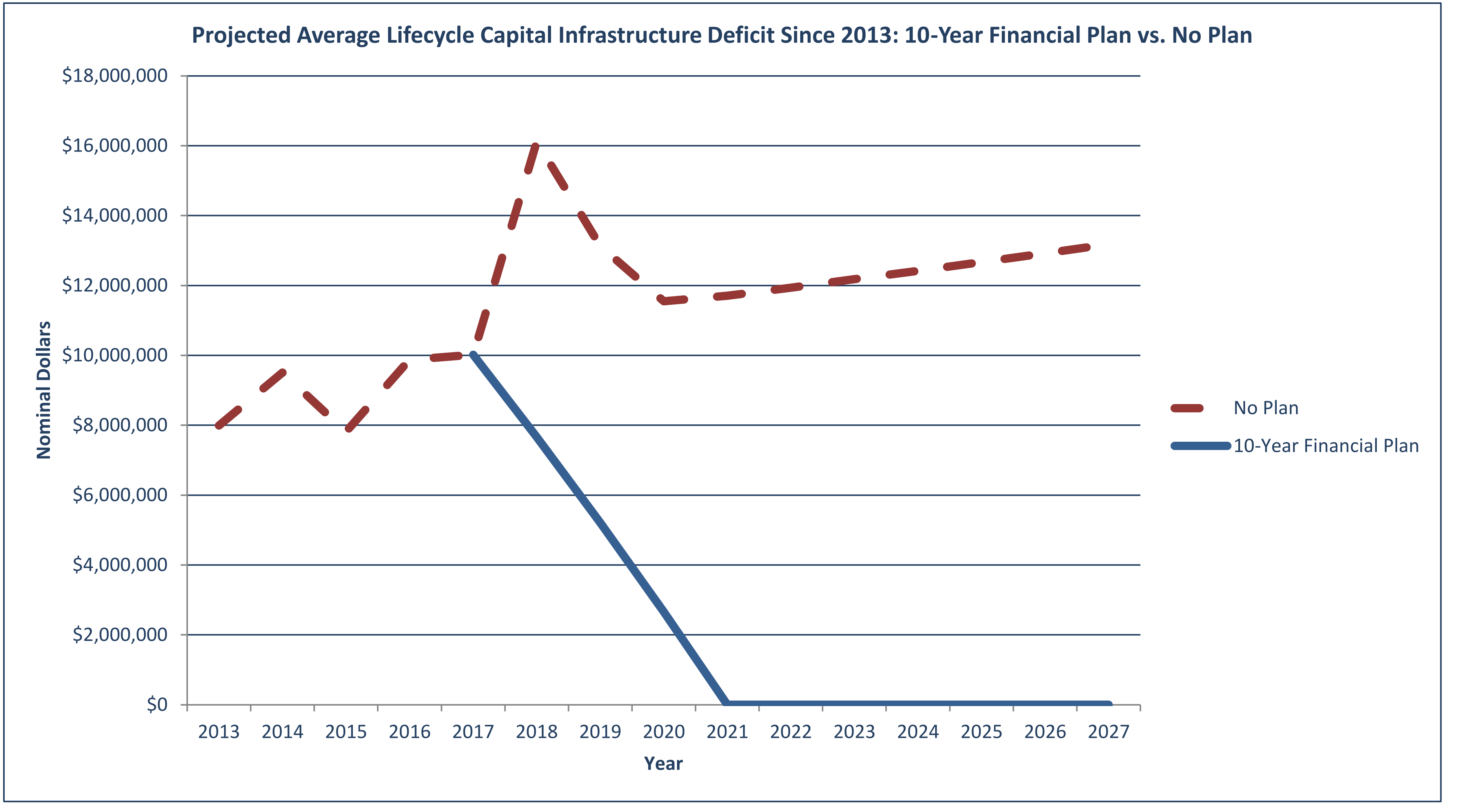
- Long-term financial sustainability is to be achieved within the planning horizon (2018-2027).

10-Year Financial Plan Elements

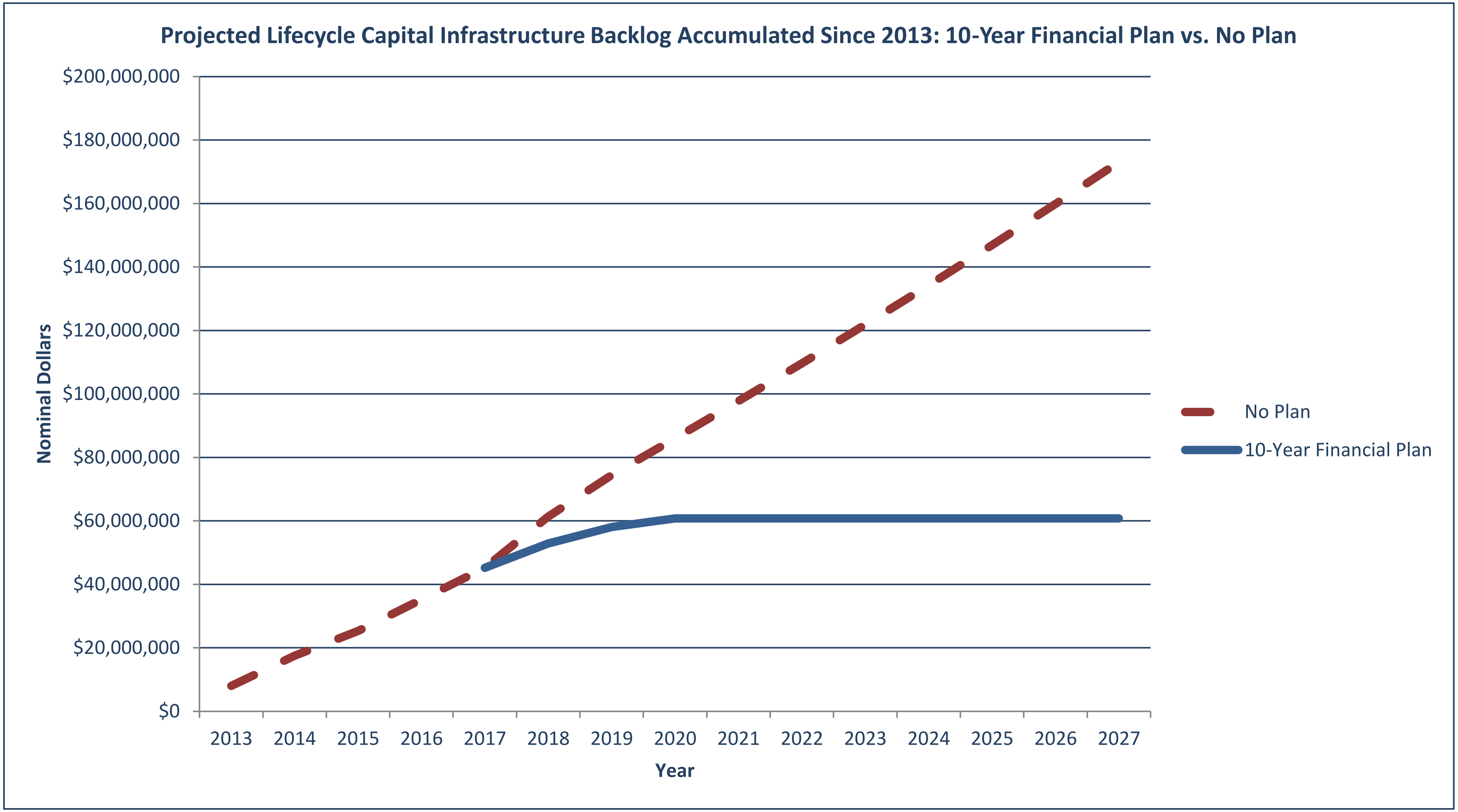
- Three dimensions of long-term financial sustainability:
  - Capital expenditure (e.g. elimination of infrastructure deficit)
  - Tax/utility rate support of capital
  - Capital reserve

- Six main considerations reflected in the recommended path to financial sustainability:
  - Service deficiencies
  - Asset-related risk
  - Ratepayer affordability
  - Debt capacity
  - Capital reserve integrity
  - Operating pressures

Tax-Supported Infrastructure Deficit



Tax-Supported Infrastructure Backlog

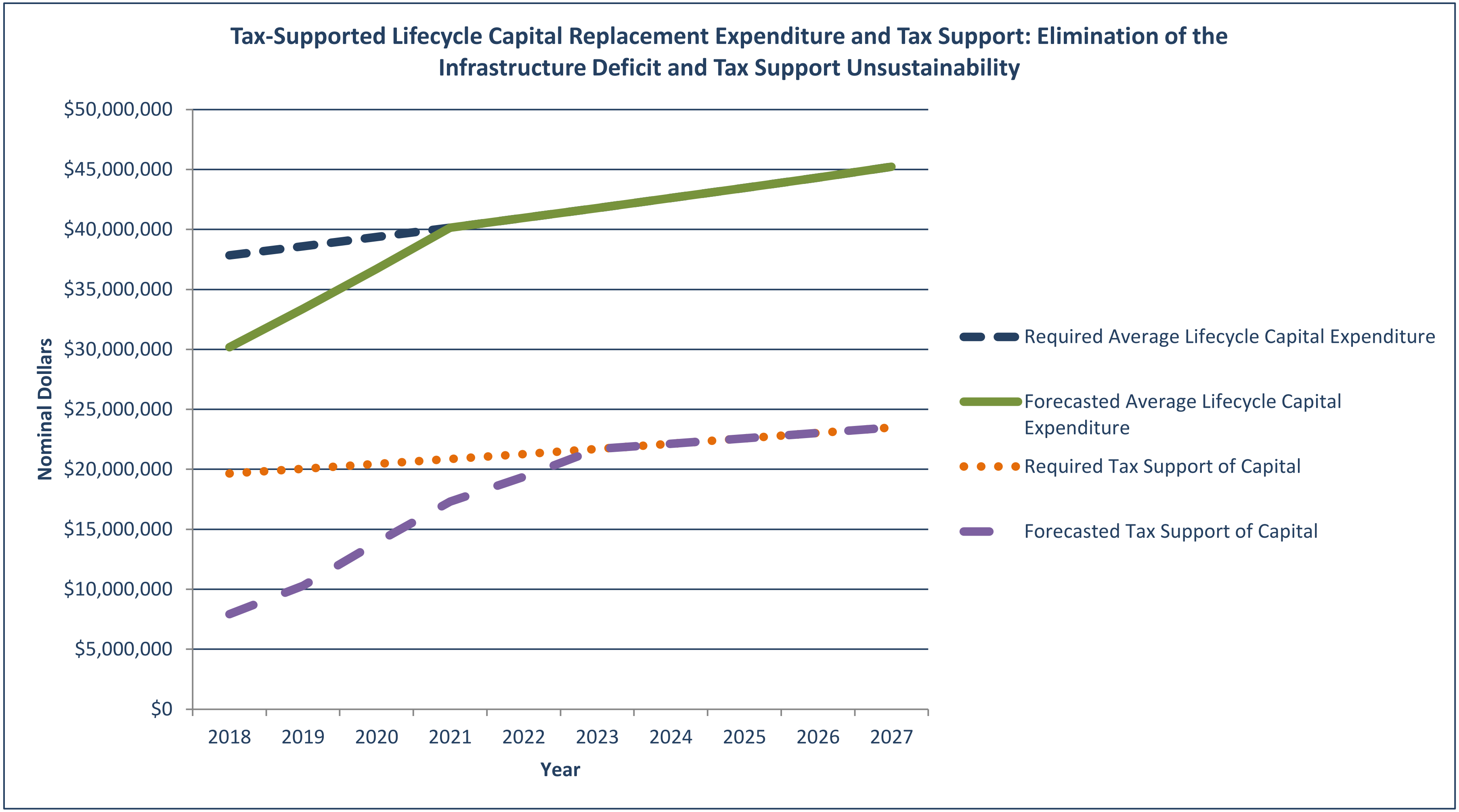


10-Year Financial Plan: A Balanced Path to Long-Term Financial Sustainability

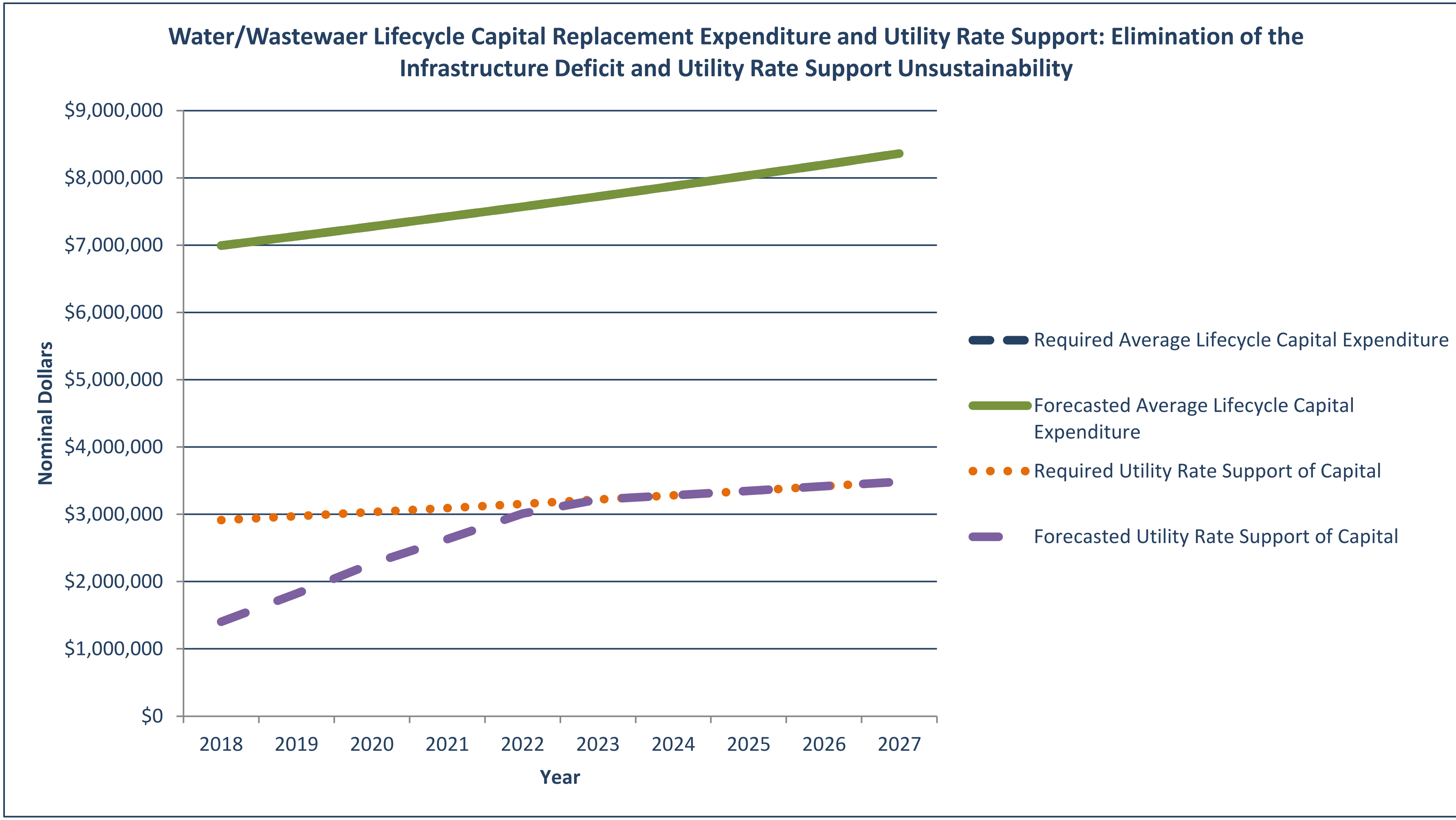
- Tax-supported capital portfolio sustainability:
  - Capital expenditure: 2021 (4 years)
  - Tax support of capital: 2023 (6 years)
  - Capital reserve: 2027 (10 years)
  - Facilitated by a $25M transitional debenture at current interest rates

- Water/wastewater capital portfolio sustainability:
  - Capital expenditure: 2017-18 (immediately)
  - Utility rate support of capital: 2023 (6 years)
  - Capital reserve: 2027 (10 years)
  - No transitional debenture required (due to SCF grant)

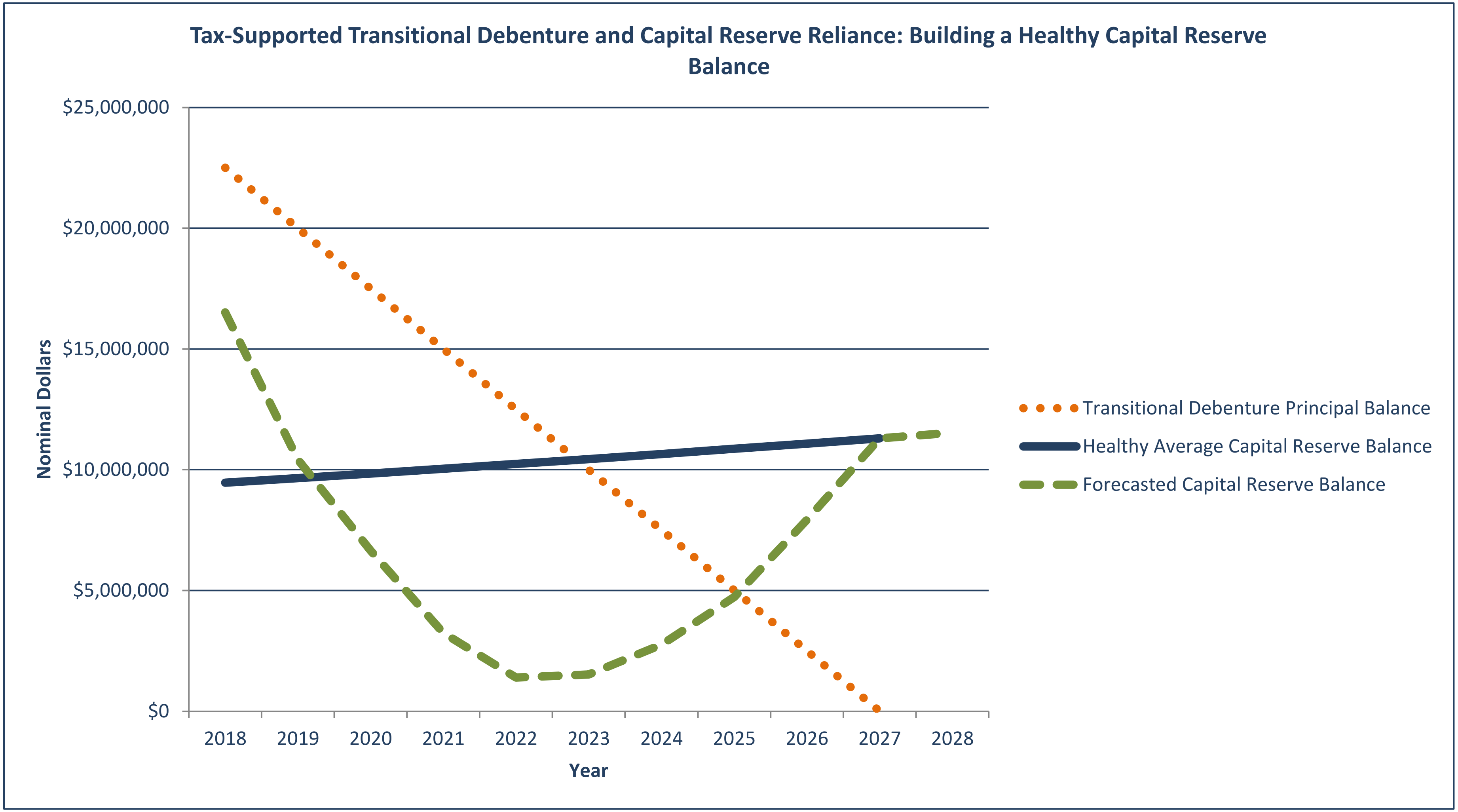
Closing the Tax-Supported Capital Gaps



Closing the WWW Capital Gaps



Building a Robust Tax-Supported Capital Reserve



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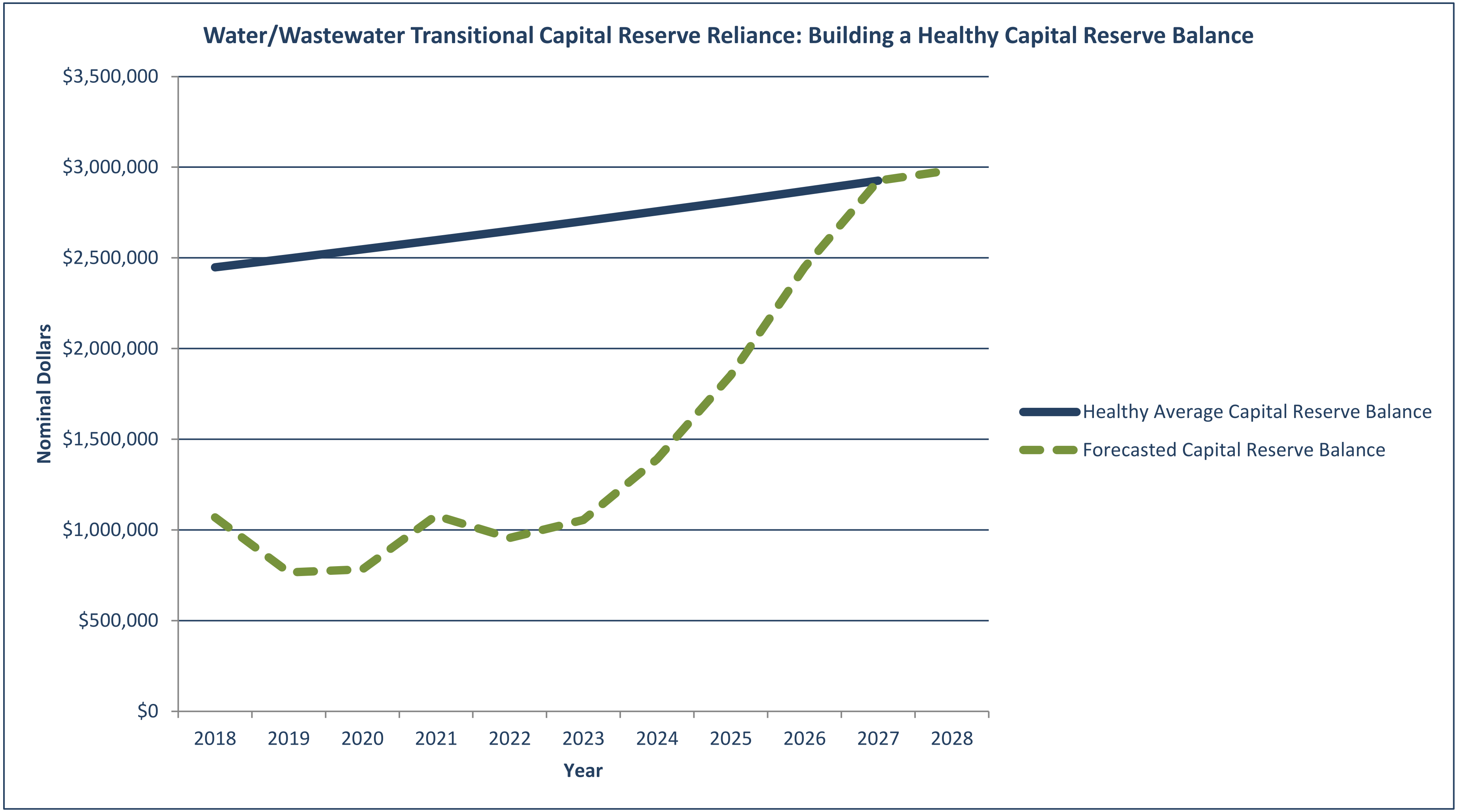
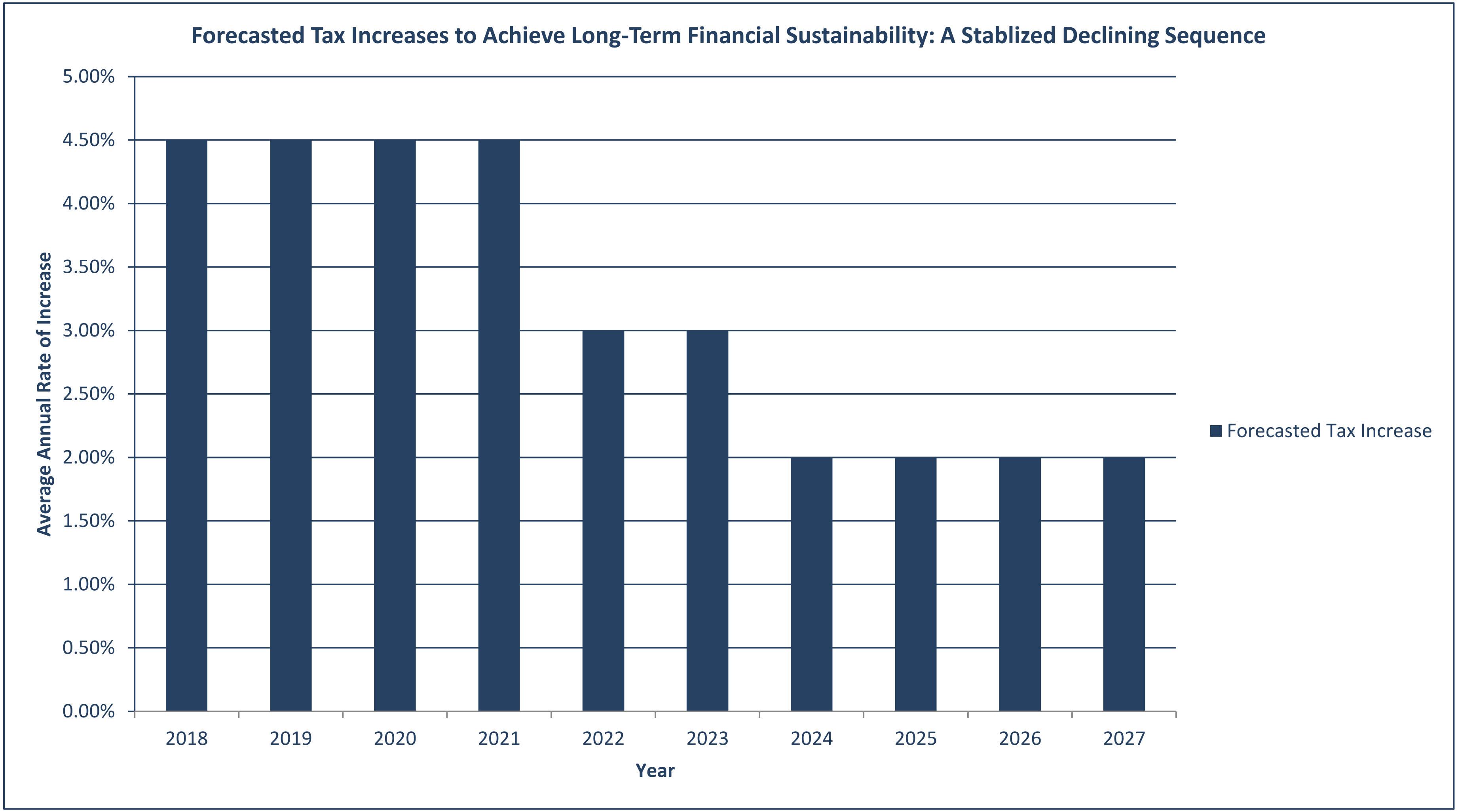


Forecasted Tax Increases



Impact of Operating Pressures

- The immediate tax-supported operating pressures amount to at least $5.3M/year.

- Meeting these is imperative, resulting in a major reduction in the starting point of the phase in of tax support for capital.

- Deferral of these would simply mean a reduction in service levels and/or the creation of deficits like that of 2016.

- In absence of these operating pressures:
  - Front-end tax increases could be reduced to an estimated 4.0%; and
  - Transitional debenture could be reduced to an estimated $13M.

Tax-Supported Alternatives

- Reduce municipal service levels and asset footprint:
  - Reduces capital need and thus transitional debenture and tax increases.
  - Example 1: Closing an average single-pad arena = $8.1M estimated reduction in capital footprint (1 facility and 1 ice machine).
  - Example 2: Closing an average fire hall = $3.3M estimated reduction in capital footprint (1 facility and 2 fire trucks).

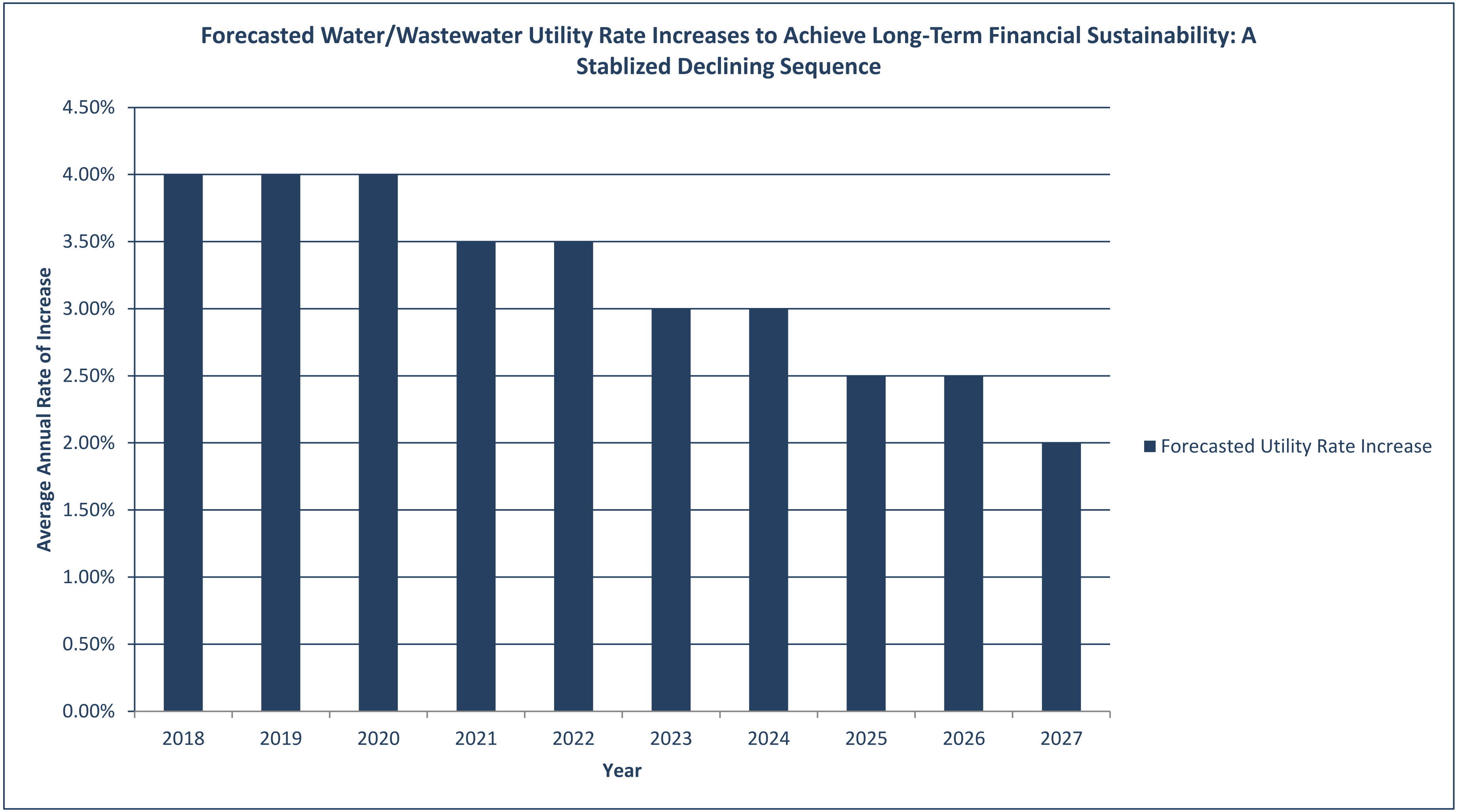
- Assume grant revenue will increase in future:
  - Forthcoming increase in Ontario Community Infrastructure Fund has already been incorporated into the plan.
  - City is already maximizing its application-based grant opportunities.
  - A risky and unrealistic assumption to make in absence of any formal announcements by senior governments.

Tax-Supported Alternatives (Cont'd)

- Issue greater transitional debt to lower front-end tax increases:
  - Increases midterm and back-end tax increases.
  - Diminishing returns to transitional debt issuance: Estimated $42M issuance needed to lower front-end tax increases to 4.0%.
  - Leaves less debenture room available for emergencies and other initiatives (e.g. gravel road rehabilitation).

- Lengthen the transition to capital expenditure sustainability:
  - Greater exposure to service deficiencies and asset-related risk.
  - Extension by just one year (to 2022) is estimated to:
    - Reduce transitional debenture to $22M.
    - Reduce 2018-2021 tax increases to 4.25%.
    - Increase 2022 and 2023 tax increases to 4.25% and 3.5%, respectively.

Forecasted WWW Utility Rate Increases



Conclusions

- Water/wastewater portfolio is in relatively good shape:
  - SCF grant permits phase in of sustainable utility rate levy and reserve balance without reliance on transitional debenture.

- Tax-supported portfolio faces major challenges:
  - $10.0M infrastructure deficit, $11.3M tax support gap and $9.0M capital reserve deficiency must be eliminated.
  - Deferral of these problems won't make them go away; it will make them even worse.
  - Indefinitely increasing debt and depleting reserves are not solutions.
  - To restore and/or meet service levels, the only solution is to increase tax support and the capital reserve to sustainable levels.

- The 10-Year Financial Plan provides a framework in which to implement an achievable solution.